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Compulsory versus Voluntary Insurance: An Online Experiment

Insurance can be classified into two broad categories: Compulsory (government/public) and Voluntary (market/private). In practice, the vast majority of compulsory insurance is partially compulsory, where compulsory insurance provides only partial coverage, and it allows for supplemental voluntary purchases (mixed insurance). In this paper, we use the Balloon Analogue Risk Task (BART) as both the assessment of risk-taking and insurance context to conduct an online experiment. The main objective is to compare purely compulsory, voluntary and mixed insurance in terms of adverse selection, moral hazard and social welfare simultaneously. We find adverse selection in purely voluntary insurance, but not in mixed insurance. Moral hazard exists in all three types of insurance, but it is smaller in mixed insurance. Finally, our results suggest that the combined effects of significant moral hazard and “no adverse selection” in purely compulsory insurance make it the insurance type with the lowest social earnings. Overall there is no crowd-out effect of the compulsory part on residual voluntary purchases in mixed insurance.

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